

VZCZCXRO4703
PP RUEHCHI RUEHDT RUEHHM
DE RUEHJA #3563/01 0790929
ZNR UUUUU ZZH
P 200929Z MAR 06
FM AMEMBASSY JAKARTA
TO RUEHC/SECSTATE WASHDC PRIORITY 1353
INFO RUEHXS/ASSOCIATION OF SOUTHEAST ASIAN NATIONS
RUCPDO/DEPT OF COMMERCE WASHDC
RUEATRS/DEPT OF TREASURY WASHDC
RUEHKO/AMEMBASSY TOKYO 9704
RUEHBJ/AMEMBASSY BEIJING 3338
RUEHBY/AMEMBASSY CANBERRA 9235
RUEHUL/AMEMBASSY SEOUL 3628

UNCLAS SECTION 01 OF 05 JAKARTA 003563

SIPDIS

SIPDIS
SENSITIVE

DEPT FOR EAP/MTS AND EB/IFD/OIA
TREASURY FOR OASIA-JEWELL
USDOC FOR WGOLIKE/4430 AND JBENDER
DEPT PASS TO USTR DKATZ AND WEISEL

E.O. 12598: N/A

TAGS: [EINV](#) [ECON](#) [EFIN](#) [ID](#)

SUBJECT: INDONESIA - GOI UNVEILS INVESTMENT CLIMATE PACKAGE

REF A) Jakarta 2315 (GOI Readies Investment Package)
B) 05 Jakarta 8877 (June 2005 CGI Meeting)
C) Jakarta 2984 (Infrastructure Plan)
D) 05 Jakarta 13579 (September 2005 CGI Meeting)

¶1. (U) Summary: Coordinating Minister for Economic Affairs Boediono and Trade Minister Mari Pangestu outlined the GOI's February 27 investment climate policy package at a March 10 meeting of the Consultative Group on Indonesia's (CGI) Investment Climate Working Group (ICWG). ICWG members welcomed the regulatory and institutional reforms and target dates, and commended the GOI for consulting closely with the business community and other stakeholders. They also noted that continuing a dialogue with business and monitoring the content of planned reforms would provide the key to implementing the package. Pangestu said the GOI would create its own internal implementation monitoring team led by the Coordinating Ministry of the Economy, as well as an external team with representatives from various business chambers. She outlined reforms underway to the Ministry of Justice's company registration process to reduce the number of days it takes to start a business. Pangestu reaffirmed that as part of the regulations implementing a new Investment Law, the GOI would move to a registration system for investments in those sectors open without conditions. Researchers from the University of Indonesia's Institute for Economic and Social Research (LPEM) presented results from its second business climate survey showing a gradual improvement in the investment climate, although taxes, customs, labor and macroeconomic instability remain significant challenges. Although the survey resulted largely positive, BKPM Chair Lutfi chided the LPEM researchers for failing to "hear both sides." Boediono listed the seven "marquee" power plant and toll road projects it hopes to fast-track in 2006. End Summary.

Economic Team Discusses Investment Policy Package

¶2. (U) On March 10, Coordinating Minister for Economic Affairs Boediono, Trade Minister Mari Pangestu, Finance Minister Sri Mulyani, Minister of Public Works Djoko Kirmanto, and Investment Coordinating Board (BKPM) Chairman Muhammad Lutfi briefed the ICWG on the GOI's March 2 investment climate policy package and infrastructure development plans. The investment climate package sets out an 85-item matrix of regulatory and institutional reforms

the GOI plans to take in 2006, along with a target date for completion of each measure and the responsible ministry. The package focuses on five areas: general investment policies; customs, excise and duties policies; taxation; labor; and small and medium sized enterprises. Over the past 18 months, the ICWG and international business community have consistently identified the first four of these areas as major obstacles for attracting greater investment. The package includes measures of significant interest to the business community and investors, including:

-- Submission of a draft investment law to Parliament by the end of March 2006 that would unify Indonesia's separate laws for foreign and domestic investors and provide traditional investment protections including national treatment, the right to repatriation of profits, and a guarantee against nationalization.

--Implementing Regulations for Investment Law: The GOI will prepare revisions to several implementing regulations that it will issue no later than the date Parliament approves the new investment law. These will include a revised Government Regulation that will set out "clear, simple, and transparent" criteria for the negative list; revisions to Government Regulation 25 on the responsibilities of local governments in the area of investment; and regulations reducing the number of days needed to establish a business (Ministry of Trade).

-- Submission to Parliament of revisions to Manpower Law (No. 12/2003) by the end of April 2006 addressing business community concerns about the cost of dismissing workers, outsourcing and expatriate work permits (Ministry of

JAKARTA 00003563 002 OF 005

Manpower and Transmigration).

-- Revitalization of a National Team for the Enhancement of Exports and Investment (PEPI) by the end of March 2006 to better coordinate investment policies and help solve high profile investment disputes (Coordinating Ministry for the Economy).

-- Acceleration of customs processing by June 2006 to 30 minutes for the green lane and 3 days for the red lane, and reduction of the use of the red lane to just 10 percent by December (Ministry of Finance).

-- A decision by the end of March 2006 on whether to withdraw amendments to three tax laws submitted to Parliament last year (Ministry of Finance).

-- Establishment of tax facilities for certain business sectors by the end of June 2006, and revisions to rules and regulations on value added taxes (VAT) to coincide with passage of a package of amended tax laws (Ministry of Finance).

13. (U) Trade Minister Marie Pangestu said that the new investment policy package demonstrated the GOI's commitment to a steady process of reform. Although the package contains a number of reforms promised since last year, Pangestu said that it remained a significant step because it establishes clearly which ministry has responsibility for which reforms and by what date. She said the package had three broad thrusts: creating a new investment infrastructure, improving tax and labor laws and regulations, and reinvigorating PEPI to better coordinate policy and resolve critical issues as they arise. Pangestu said the GOI knows of the business community's growing concern that the Government continues to say all the right things, but fails to execute.

ICWG Members Praise the Package

14. (SBU) A number of ICWG members praised the comprehensiveness of the package, and complemented the GOI for consulting closely with the business community and other stakeholders as it developed the package. They encouraged the GOI to focus on implementation. In his remarks, the Ambassador emphasized that with so many reforms planned over the next year, the GOI will face a major challenge monitoring the content of proposed measures, including establishing a mechanism to seek comments on draft regulations from stakeholders. He urged the GOI to continue close cooperation with the business community and other stakeholders. The Ambassador welcomed the GOI's focus on reducing the number of days needed to start a business from 151 to 30 days, which he noted has become a symbol of Indonesia's determination to improve the investment climate. He added that President Yudhoyono's pledge to move from an investment approval to an investment registration system provides another important symbol for investors; he asked Pangestu how the GOI planned to move forward on this issue. (Note: The package does not refer explicitly to this issue.)

15. (SBU) World Bank Country Representative Andrew Steer described the GOI's February investment and infrastructure policy packages as comprehensive documents and major milestones, especially in light of real political challenges. Steer said he saw the GOI leadership as serious about pursuing the investment climate reforms and remained optimistic that implementation of the package will prove successful. Steer expressed less confidence about the GOI's ability to meet the broad commitments in its recent infrastructure package. Steer agreed with Ambassador Pascoe's emphasis on implementation, and recommended that the GOI provide monthly progress reports.

16. (SBU) American Chamber of Commerce (AmCham) President James Castle described as unprecedented the level of cooperation between the Indonesian Chamber of Commerce and Industry (KADIN) and international chambers, with support

JAKARTA 00003563 003 OF 005

from embassies. He said the Yudhoyono Administration differs from its predecessors in that, despite some criticism, it has avoided becoming defensive and remained open to input and frank discussion. The Japanese, EU, Netherlands and Korean Ambassador's also urged close GOI consultation with the business community and other stakeholders throughout the implementation process. The UK Ambassador asked about GOI risk sharing and guarantees for infrastructure.

GOI to Establish Two Monitoring Teams

17. (U) Pangestu explained that the Presidential Instruction 3/2006 directs the Coordinating Ministry for Economic Affairs to establish two teams to monitor implementation of the investment and infrastructure policy packages. Jannes Hutagalung, Staff Expert at the Coordinating Ministry for the Economy will head an internal GOI team under the framework of the PEPI to report whether responsible Ministries implement measures on time, and produce a monthly report that Pangestu said could go outside the GOI. Pangestu noted the GOI currently still sought a credible chairman for the second team, which would monitor the content of reforms as well as their effectiveness, and would consist of officials from the GOI, KADIN and representatives from other professional associations. .

GOI Eyes Cuts in Days to Start a Business

18. (U) Pangestu said the GOI has finalized its draft of the new investment law, which the State Secretariat has begun processing prior to delivery to Parliament before the end of March. The new law and its accompanying regulations will

establish new investment procedures and reduce the time needed to establish a business. In response to the Ambassador's question about the planned shift to an investment registration system, Pangestu said that under the new rules, an investor in a sector not closed or subject to certain conditions could begin working immediately to establish a legal business entity through the Ministry of Justice and Human Rights (MOJ) and to obtain technical, location and other licenses.

¶9. (U) Pangestu explained that the MOJ business establishment process currently consumes about half (75 days) of the 151 days required to start a business in Indonesia. A recent survey, however, showed that the MOJ already has reduced the time needed for business establishment to 30 days. The GOI expects to reduce this to five days by moving the process online and delegating more authority to district level MOJ offices. After the MOJ issues required establishment papers to new businesses, the state gazette would record and publish a list of established companies.

¶10. (U) Depending on the project, Pangestu noted that investors might yet need some central government technical licenses or approvals. All other licenses and approvals would fall to district governments. Pangestu said 15 districts have integrated service centers offering all types of licenses and permits to establish a business. She reaffirmed the GOI's goal of reducing the time to start a business from 151 to "around 30 days." Pangestu and BKPM Chair Lutfi said the BKPM has reduced the time needed for businesses to obtain initial BKPM approval to five days.

Business Climate Survey Shows Some Progress

¶11. (U) Dr. Ari Kuncoro of the University of Indonesia's LPEM presented the LPEM's second World Bank-funded investment climate business survey (LPEM presented the first survey to the June 2005 ICWG meeting). The survey of 500 manufacturing firms in five cities showed improvements in the overall investment climate, but with persistent problems in taxes, customs and labor. Key results include:

-- Firms' perceptions of the investment climate improved

JAKARTA 00003563 004 OF 005

from 2003 to the end of 2005.

-- Businesses must file seven types of tax returns and devote 41 worker days each month to this, down from 44 days in mid-2005. "Harassment visits" by local authorities and informal payments demanded dropped significantly between the first and second survey, but firms still receive an average of 15 visits by local officials every 6 months.

-- Public Utilities improved slightly, with a small decline in brownouts and water utility problems, but no decline in blackouts or telephone failures.

-- Strikes declined, demonstrations remained the same, and few firms reported labor disputes.

-- No significant improvement in the number of days to clear imported goods through customs since a 2004 survey by the Japan International Cooperation Agency (JICA). Some 85 percent of respondents said they must make informal payments to get customs clearance, up from 81 percent in mid-2005. These payments average one percent of the import value of goods, with half paid to customs officials.

-- Fifty-seven percent of respondents reported making unofficial payments to tax officials to obtain value added tax (VAT) refunds, the same percent as in the first round of the survey. Respondents reported the time it took to obtain a VAT refund increased from 5.2 months in mid-2005 to 6.1

months now. On average, 84 percent of VAT claims get refunded, down from 88 percent in mid-2005.

-- Road quality remains the biggest infrastructure problem, with 22 percent of respondents claiming that travel time has increased, and 10 percent claiming it has decreased.

-- Thirty-one percent of respondents said current labor regulations reduce competitiveness, with severance pay and lay-off procedures cited as the biggest obstacles. Although wage disputes increased between the first and second half of 2005, strikes and labor disputes declined.

-- BKPM approval time improved from 36 days in first survey to 20 days in the second. This figure does not include the time needed to correct and resubmit forms the BKPM deems incomplete. Respondents indicated that on average the BKPM rejects applications twice before it deems them acceptable. The survey also noted that BKPM often requests changes to information, such as increasing the amount of capital invested or changing the shareholding structure, and that many rules or policies remain unclear, including the minimal capital investment.

BKPM Head Lutfi Reacts Strongly to Survey

¶12. (U) Minister of Finance Sri Mulyani complimented LPEM's efforts and noted that the survey results helped the GOI identify real underlying problems. The Minister agreed that the customs and tax offices, both under her Ministry, had the biggest problem areas and should remain a focus of reform efforts. On VAT, she noted that when Minister Boediono had served as Finance Minister the GOI reduced the time it took to obtain VAT refunds from twelve to two months. This came with a cost, however, as the number of fraudulent claims increased dramatically. To address VAT problems, Sri Mulyani said the Director Generals of Tax and Customs will seek to establish better information sharing with the business community and a customs single window system. She asked that the business community support these efforts and maintain realistic expectations. Lastly, she noted that the LPEM data provided her ammunition to push the Director Generals to do more.

¶13. (U) BKPM Chairman Lutfi reacted defensively. He denied an LPEM finding that the BKPM, without notifying the public, had discontinued processing applications for foreign investments below USD 250,000, and cited several examples of BKPM approvals below this amount. He defended delays caused when investors have to correct and resubmit their

JAKARTA 00003563 005 OF 005

applications, noting that a "driver's license application is not complete without an attached photo." He said mistakes remain common because some companies use inexperienced attorneys, couriers or even office boys to submit applications. Lutfi, however, acknowledged the existence of room for improvement, and vowed that the BKPM would try harder. Speaking immediately after Lutfi, Coordinating Minister Boediono welcomed Lutfi's remarks as "well taken, especially the promise to try harder."

Boediono Gives New Details on Infrastructure Package

¶14. (U) Boediono provided details on the GOI's February 17 infrastructure policy package. He said that Vice President Kalla would have a major role in its implementation, since the Vice President has a "passion for getting things done." He presented a power point slide listing one power plant and six toll road "marquee" projects that the GOI would accelerate to show investors its determination to move forward. Boediono declined to offer details on plans for risk sharing on infrastructure projects, noting only that the GOI favored setting aside a portion of the budget to

serve as a contingency fund to back up GOI guarantees or contingent liabilities.

Comment:

¶15. (SBU) With the announcement of these policy packages, Boediono has laid out a detailed and ambitious work plan for ¶2006. The basic hope behind the time-bound, matrix-based approach remains public and business pressure to encourage line ministries to deliver promised reforms. In contrast to the Megawati Administration's 2003 "White Paper," this time the GOI plans a more robust monitoring effort including consultation with the private sector and other stakeholders. We anticipate difficult battles, and the GOI will need help from the business community to keep its investment climate reforms on track. PASCOE